

**GREY  
DIRECT**

September 28, 1990

Ms. Elizabeth Butson  
Vice President, Director of New Products  
Philip Morris Inc.  
120 Park Avenue  
New York, New York 10017

CONFIDENTIAL

Dear Elizabeth,

Grey Direct Marketing Group Inc.  
875 Third Avenue  
New York, NY 10022  
212 303-2300

George S. Wiedemann  
President  
212 303-2310

It was a pleasure to meet with you last week to discuss the possibilities of using direct marketing to enhance the new product process. I was most impressed with your statement that it costs up to \$10 million to test a product in the marketplace. It is not only intriguing, but also potentially cost efficient should a direct marketing-based consumer panel develop into a method to bypass some or all of that expense. Thank you for asking me to think about the problem and to propose a solution.

For the last week I have devoted my thoughts to the task of constructing a New Products Direct Marketing Laboratory for Philip Morris. Grey Direct is one of the country's largest direct marketing agency resources, with billings last year of \$119 million, making us the sixth ranking agency in the country. We are also the third largest agency in New York. It isn't just our size that makes it appropriate for us to address the challenge of new product marketing. Grey Direct has had many new product experiences, with national advertisers like GM, Shell, IBM and major direct marketers like The National Geographic Society. We are currently working with Clairol to launch a major new product. These clients give us a base of experience from which we can recommend to you a way to use direct marketing to:

1. Evaluate the strength of a new product idea from a representative panel of smokers.
2. Evaluate marketing strategies and creative executions for effectiveness against the target market.
3. Tie the results back to Philip Morris database assets so that they may be efficiently deployed in service of a launch.

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4. Begin the process to calibrate the direct marketing laboratory findings to live in-market testing (I must inject the caveat that this is really the \$64,000,000 question, and that all our professionals are not certain of what the range of error might turn out to be at this time or whether it is possible to forecast volume).
5. Allow a new product to be put to the test for modest cost levels, more like the \$200,000+ range rather than the \$10,000,000 range.

These may seem like ambitious objectives, and they are. The proposal that follows has elements that are each based on a successful precedent drawn from experience with our other clients. The unique centerpiece of this proposal is that it is based on relationship marketing thinking as much as it is on traditional research thinking. It posits the notion that it is an advancement to current research methods to use a special group who have a relationship to smoking in general, and of course many of the panelists to Philip Morris in particular. Because it is ambitious, but based on substance, it strikes me that there is opportunity herein for a breakthrough technique.

Having said all of that, let me add that we are well aware of the precedent set by Beecham, who sued Yankelovich for misdirection based on their "simulator" projections. There are so many in-market tests that it would seem there is no substitute for most marketers when volume projections are the goal. Having delivered the caveat that a laboratory can never be a substitute for a live test, and realizing the daunting challenge of creating a useful, valid instrument for you, let me proceed with the proposal that follows.

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## THE PHILIP MORRIS NEW PRODUCTS DIRECT MARKETING LABORATORY

### I. Management Overview

The DML (Direct Marketing Laboratory) consists of three main elements. They are THE PANEL, THE EVALUATOR, and THE SIMULATOR.

The Panel is a group of smokers formed from the Philip Morris family (database) as well as from the balance of smokers. We envision extending invitations to join the panel, for which we have the working title "Smokers International", and selecting a balanced, representative, minimum sample of 2000 smokers, which should meet our purposes.

The Evaluator is a research instrument sent to the panel for the purpose of measuring different concepts or positionings of one concept against segments. It can be used to test the strength of up to three different product ideas (which we think is the maximum prudent attempt) against three segments. The second purpose of Evaluator is to rank the strength of one new product concept (with up to three positioning expressions) as measured by the breadth of its appeal across segments, and its depth, meaning potential to penetrate segments.

The Simulator is a research instrument sent to the panel for the purpose of measuring the total offer: packaging, product, price, promotion, coupon value, advertising. It has the interesting feature of either being used for testing marketing system and creative variations, or for testing varying levels of sampling (some cigarettes take with modest sampling, others require a lot).

Results from the Evaluator are used to decide what to put into Simulator (Evaluator assumes that there has been the usual product testing preceding the concept tests).

Simulator is used to understand how to sell the product concept.

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Both E and S measures are used to calibrate to live in-market testing. We envision that the DML would run parallel to some live tests to see if it is possible to calibrate its findings to the real world.

S measures tie back to the Philip Morris (and outside) databases for optimizing name selection should mail be part of the launch system. This has interesting implications for tying in to local retail geographies, if Philip Morris also has a database of brand volume by retail account/location (KGF has one).

Like all research tools, our goal is to create a standard set of measures which indicates success with high confidence, if we decide to go ahead and launch the brand. At its most modest level, the DML might simply provide a means, along with other research findings, to limit the \$10 million in-market investments to the most promising DML concepts. The DML will provide rich feedback and diagnostics.

## II. The Panel

To form the panel is itself an interesting challenge. It is exciting to think about a group that would enter a relationship with us to provide feedback.

We want to create a privileged group called Smokers International. Membership is by invitation only. Applications may be rejected, so that we can cull from a large sample, say 10,000, down to a workable, minimum group size of 2000 (it is important to note that if the product being tested has a small incidence of users, costs may increase as our panel expands to adequately represent that user segment; if there is to be a lot of niche activity, then we may need a larger group than 2000, making for more expense). About 20%, or 400 of the group will drop out each year, just due to the natural turnover in groups, and they will have to be replenished. Assuming a 5% response, it will take a 200,000 piece mailing to form this group. It will take another 40,000 pieces of mail to replenish the group each year. At \$350 per thousand, this amounts to roughly \$80,000 to form and maintain the group. It may prove to be more efficient and natural to acquire our panelists/members through print advertising (we did it this way in the UK for Sheba cat food, a Mars product). It may be desirable to test this approach versus mail. Mail is personal and private, if we choose not to be public about Smokers International.

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The turnover of members is actually an advantage, because we do not wish to create a stagnant group of professional smoker evaluators. The turnover keeps the group somewhat like the random samples drawn for traditional research, but also provides a base of stable experience. It is balanced by its own turnover.

Considerations for forming the panel must be to recognize the need to represent the appropriate segments for the product being tested, for example: age, sex, menthol (flavored), regular, niche brand vs. mass target smokers (brand consumption profile), Philip Morris brands, competitive brands, attitude/lifestyle segments.

The offer to members is to participate on the cutting edge of smoking research. They will get benefits and privileges in return. This is estimated to add another \$20,000 to the cost of the panel each year.

Total annual panel costs: \$100,000.

### **III. The Evaluator**

The Evaluator is based on the underlying notion that there is a switcher prospect profile. Smokers enter the market, usually on a mass brand, and then begin to express themselves individually by age 25, or thereabouts. Other life stages and events set up switching behavior, along with a myriad other things. Since the market breaks up into these segments, the Evaluator recognizes that it is important to measure concepts (as expressed by the image, lifestyle or attitude conveyed by the brand) against target segments.

Evaluator uses a matrix to test product positionings against segments. It assumes that a cigarette has made it through product testing (as opposed to market testing), or is at least a cigarette that someone wants to make and is possible to make and is ready for being positioned. The Evaluator takes up to three positionings, or concept statements for the product, and measures their vitality with the panel.

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The instrument used by Evaluator is a mailing to the panel, asking the recipient to smoke a sample of the product and evaluate the strength of appeal of our concept expression. We want the recipient to rank the concept against the brand they now smoke, indicating propensity to trial. If we have a switcher prospect profile for the smoker, we will develop estimates for switching behavior, based on willingness to try our concept.

The mailing is organized into a matrix design that gives us a reading of three concept statements against three segments, as illustrated below:

	Segment #1	Segment #2	Segment #3	Total
Concept A				
Concept B				
Concept C				
	Seg 1 Tot	Seg 2 Tot	Seg 3 Tot	Grand Total

Across, we get a total score for concept A, and we know which segments it appeals to. Down, we get a total score by segment along with a reading of which segment is apt to most strongly support the concept. We also get a feeling for how big the brand idea is.

This design could possibly accommodate more segments, but we don't think it wise to try to get a reading on more than three positionings.

The net result from the Evaluator is that, given a cigarette we can make, we know what positioning of it has the widest appeal, or the segment to which it has the strongest appeal. We can tie back to the database and see where our business must come from. We can get an estimate of how big the brand can be with the best positioning.

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The second use for the Evaluator takes three separate concepts, expressed in only one positioning, and evaluates them.

Naturally, with the first measures, even though we have evaluated our concept against the current brand of the smoker, we more surely know which positioning is best than how much trial and switching to expect. This becomes part of the calibrating problem, and volume estimates can only become reliable over time as experience builds up (assuming volume estimates are possible).

### **IV. The Simulator**

The Simulator uses a more elaborate instrument, because Simulator tests and evaluates the total offering, which is represented by the packaging, the cigarettes, the price, the advertising and promotion, and coupons. These materials are sent to the recipient in a container which is marked "research". They are asked to read the advertising, promotion, etc. and to sample the product. Each element of the "total offer" is researched in a survey (this is sometimes a mail survey, other times a phone survey, and we think for DML we might want people to actually respond to offers for more product as a way to measure purchase intention). We will collect measures of the propensity to switch. Rich diagnostics of the elements (packaging, product, ads, etc.) can come out of this exercise.

The Simulator sample has been drawn carefully with guidance from the Evaluator. Whether we are testing a mass or niche concept, regular or menthol, etc. will cause us to select the proper sample from our member base of 2000 (or increase the group to find smokers we need).

We envision dividing the sample in order to test either total offer variations, such as package design, advertising creative, promotion techniques, etc. or to test levels of sampling.

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This second division of the sample is exciting to us, because in our experience one of the tricky factors in a new cigarette launch is the degree to which the product must be sampled in order to create a switch. Sometimes a 5-pack is sufficient. Sometimes it's 20. Sometimes it's two cartons. Simulator might be most valuable to shed light on variations of sampling and promotional pressure.

To be frank and honest, the hardest problem to solve with the Simulator will be to relate its measures to the real world to provide reasonably accurate volume forecasts. We cannot begin to guess about this work, but we do know that firms that use direct mail simulation have built up a long experience with their simulators. They always relate simulator findings to the in-market tests. They have a "feel", in other words, for which numbers they can trust, and which ones they can't.

One of the interesting aspects of having a direct marketing relationship with the panel, is that in Simulator, we can construct it so that they can actually respond to promotion, and/or offers for more product. We can relate this "real response" to test market trial and repeat behavior. It may be a harder measure than a typical research response, because we have recorded an actual behavior as opposed to a person's statement of intention, which always carries some inflation.

The net result of Simulator is that we should know, among three expressions of total offer, which one delivers the strongest set of measures. After time, we would hope that these collective measures would become reasonable predictors of live market volume.

### V. Development Timing and Costs

Since the Direct Marketing Lab is a new invention, it is best to develop it in a phased approach. This allows us to get it right, test it out, and minimize risk. If we like what we see, we proceed. If not, we can stop development having risked little, and hopefully learned a lot. Below are the phases, tasks, timetables and costs estimated for developing the lab:

- |  |            |
|--|------------|
| 1. Panel Development Four Months                                     | \$100,000  |
| 2. Evaluator Efforts Six Months                                      | \$100,000  |
| 3. Simulator Efforts Six Months                                      | \$100,000+ |
| Simulation costs much more depending on what goes into a simulation. |            |

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The above costs are very rough, ballpark estimates. Grey Direct estimates costs very tightly against tight specifications. Should we be retained to work on DML, Philip Morris can expect to receive tight estimates for all out of pocket expenses connected with the panel development. Subsequently, each specific estimate of an evaluation effort, or simulation effort, will be accompanied by an individual estimate. Our system functions so that no expenses may be incurred on a client's behalf without their signature on an estimate (in other words, we run a "no surprises" business).

4. Agency Fee Monthly	\$15,000
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To get an approximate forecast of the cost of embarking on the development of the DML, the first year might cost as follows:

Panel Development	\$100,000
One Evaluator	100,000
One Simulator	100,000
Agency Fee for One Year	180,000
Total	\$480,000

As stated above, it is more pragmatic to approach the development of the DML in phases. We see the above annual expense divided into the following phases:

## Phase I

Develop the panel. Four months.

Agency Fee	\$60,000
Out of Pocket Expense*	\$100,000
Total Phase I	\$160,000

## Phase II

Conduct an Evaluation and  
DeBug the Evaluator.

Plan the first Simulator. Six months.

Agency Fee	\$90,000
Out of Pocket Expense*	\$100,000
Total Phase II	\$190,000

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Phase III

Continue fielding Simulator. Two months (the process may continue into the second year of effort).

Agency Fee	\$30,000
Out of Pocket Expense*	\$100,000
Total Phase III	\$130,000
Total All Phases (Year 1)	\$480,000

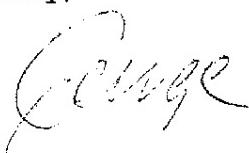
\*All of the above costs are rough estimates for the out-of-pocket expenses (which will be tightly estimated after specifications are settled).

Naturally, the proposal represented by this letter is the product of one week's invention time, has not been presented in person, and does not reflect working with you interactively, which would no doubt improve its quality and relevance to Philip Morris new product marketing. If you choose to retain us to develop the DML, our first task is to use this proposal as a foundation for writing a tighter action plan for the work, taking into account all your inputs and modifications.

Even though the proposal is for a formative research tool - the Direct Marketing Laboratory - it is based on past efforts of the agency. Working on its design gives me confidence to say that it strikes me as a tool with substance and promise, and is worth finding out about. It seems particularly relevant in an age when all marketing is becoming more concerned with relationship marketing, and cigarette marketing in particular will performe be more and more involved with it.

I would be more than delighted to meet with you to go over the proposal, should you wish to go forward. I speak for my colleagues when I say that we eagerly await your response.

Cordially,



cc: Mina Fung  
Tim Teran  
Wendy Lurrie

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